BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF DELAWARE

IN THE MATTER OF THE APPLICATION OF CHESAPEAKE UTILITIES CORPORATION FOR APPROVAL OF NATURAL GAS EXPANSION SERVICE OFFERINGS (FILED JUNE 25, 2012)	)))))	PSC DOCKET NO. 12-292

DIVISION OF THE PUBLIC ADVOCATE POSITION PAPER
RE: CHESAPEAKE UTILITIES CORPORATION EXPANSION PROPOSAL

Introduction

On June 25, 2012, Chesapeake Utilities Corporation ("Chesapeake" or the "Company") filed a Petition with the Delaware Public Service Commission (the "PSC") proposing new rates and offerings to facilitate the proposed expansion of natural gas service, primarily in eastern Sussex County, Delaware. Chesapeake also seeks changes to its existing natural gas tariff pages regarding new installations.

First, Chesapeake proposes an Infrastructure Expansion Service ("IES") Rate to finance the extension of the natural gas distribution system into Sussex County. The IES rate would be a fixed charge of between $8 and $125 per month for customer classes in a specifically defined area of Sussex County. Residential customers would pay either $8 per month or $25 per month depending on whether they were heating customers. General Service customers would pay $40 per month and medium volume customers would pay $125. Chesapeake does not propose to assess the IES charge to LVS or HLFS customers.

Second, Chesapeake proposes a Distribution Expansion Service ("DES") Rate of $1.25 per month ($15 annually) to be paid by all existing and future Chesapeake customers. Chesapeake says that the DES rate is intended "...to support the administration and implementation of the proposed service offerings along with the enhanced customer growth anticipated as a result of the proposed natural gas expansion service offerings." (Tietbohl Direct Testimony, page 16).

Third, Chesapeake proposes a Conversion Financing Service ("CFS") for customers interested in converting their existing equipment and internal fuel piping to natural gas. As proposed, the maximum level of assistance will be $1,500 for residential customers and $3,000 for commercial customers. Chesapeake will offer 3, 5 and 10-year payback periods, with a return component equal to its authorized rate of return. (*Id.* at 24). Chesapeake further proposes an optional Conversion Management Service ("CMS"); for a one-time fee of $100, Chesapeake will assist the customer in managing the conversion process with outside contractors performing the work.

Fourth, Chesapeake proposes a tariff amendment to change the measure of service installations from the current method of six (6) times net-revenue test to an Internal Rate of Return-based model. Chesapeake maintains that "the current parameters will not be sufficient going forward, especially considering the Company may be converting existing communities and developments with a significant number of customers." (*Id.* at 27-28).

Finally, Chesapeake proposes to eliminate tariff provisions that prohibit charging for service installations within (75) feet of an existing distribution main, or for extension charges of less than (100) feet. The amendments would enable Chesapeake to charge for these services.

DPA Discussion and Recommendations

The DPA supports expanding the availability of lower-cost natural gas into eastern Sussex County and making it available to more residents in other parts of the state. In this regard, the DPA observes that the Company's tariff includes Section 6.4 titled "Experimental Area Extension Program" that is applicable to residential extensions of natural gas facilities. That section, which was approved in Order No. 7434 in Docket No. 07-186, provides:

> For residential facilities that are to be extended to one discrete geographic area and require a CIAC, the Company may establish an Area Extension Program ("AEP") on an experimental basis to recover these costs plus interest at a rate equal to the Company's cost of capital. The AEP amount will be billed to customers served by the extension program providing that the CIAC can reasonably be expected to be collected over an amortization period not to exceed ten years.
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> The AEP, which shall be stated on a per Ccf basis, shall apply with respect to all natural gas sold or transported to Company customers located within the applicable discrete geographic area during the amortization period.
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> AEP rate will be calculated by dividing (1) the amount of additional revenue required in excess of the Company's applicable tariff rates, including any taxes calculated on gross revenue, by (2) the volume of gas reasonably forecast to be sold or transported to customers within the applicable discrete geographic area during the amortization period. The additional revenue required is the allowed cost of capital as determined in accordance with the Company's internal rate of return model on file with the Public Service Commission.
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> EP amounts collected shall be used specifically to amortize the cost of the project facilities within the applicable discrete geographic area requiring a CIAC. If the AEP collected is sufficient before the expiration of the amortization period to fully amortize the excess costs, including the provision for the accumulated cost of capital, the AEP for said discrete geographic

> area shall terminate immediately, and the Company shall promptly credit the affected customers for amounts over collected, if any. The Company will absorb any under recovery in existence at the end of the amortization period.
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> The Company shall have the right to reassess the amount of revenue available to recover the unamortized excess cost of the facilities on an ongoing basis and recalculate the AEP rate as needed, provided, however, to the extent that any change in the AEP rate is required, the Company shall only have the right to change the rate once during the amortization period, subject to the maximum rate limitations set forth above.
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> The initial AEP rate computation and any further change to the established rate will be submitted to the Public Service Commission for review and approval prior to the effective date of the surcharge. The AEP rate will then appear on Rate Schedule "AEP" in the Company's tariff. The Experimental Area Extension Program will be evaluated by the Commission at the expiration of 18 months after the filing of the one trial AEP application.

Unlike the Company's current proposal, the Experimental Area Extension Program provision has been vetted by many of the parties participating in this docket (including the Delaware Association of Alternative Energy Providers), is cost-based, and does not create a subsidization issue. To the best of the DPA's knowledge, however, the Company has not attempted to expand the availability of natural gas into unserved areas under this tariff provision. Furthermore, the Company's application and supporting testimony never mentions Section 6.4, so there is nothing in the record from the Company that explains why Section 6.4 would not enable it to accomplish the goal of expanding the availability of natural gas. At the very least, the Company should explain why the Experimental Area Expansion Program would not accomplish its goal.

As will be discussed in greater detail below, the DPA does not support the Company's proposal to achieve that expansion. First, the DPA opposes single-issue ratemaking, which, at its core, is what this proposal is. Second, given the Company's current capital structure that is heavy on equity, it would appear that the Company is in a financial position to allow it to finance the expansion with additional debt rather than obtaining expansion capital from ratepayers. Third, in the DPA's view, the Company's proposal is not cost-based and would result in current customers subsidizing the expansion. If Chesapeake truly believes that the Experimental Area Expansion Program is not a viable option, and it is not willing to finance the expansion itself, then the proposal should be vetted in the context of a full rate case to enable all parties to examine all revenues and costs.

During informal meetings in this case, the Company disclosed its current capital structure. That capital structure is heavy on equity and light on debt. DPA suggested that in light of this capital structure and the current low cost of debt, the Company, not current and future ratepayers, should finance the expansion. The Company was not receptive to that suggestion; however, DPA believes the Commission should consider the Company's financial situation in deciding whether to place the risk and cost of expansion on ratepayers.

IES – DPA recommends that the PSC reject the Company's proposed IES at this time. There are too many unanswered questions for the proposed IES rate to be approved. The data presented by the Company to support its proposed rate shows that the proposed IES rate is largely based upon the price differential between natural gas and propane. While the Company has provided some incremental cost data, the discussions at the workshop and the responses to discovery shows that the proposed IES rate is not cost-based and was not developed with consideration of all of the appropriate ratemaking principles applicable in a base rate case. If the Company believes that it is necessary to charge higher rates in a portion of its service territory to promote expansion, that issue should be examined in a base rate case, in which all appropriate costs can be reviewed and appropriate cost allocation methods can be developed. Therefore, the DPA does not believe that there is sufficient evidence to approve the IES at this time.

If the PSC decides to authorize the IES, then DPA recommends that all revenues received from the IES be recorded as a contribution in aid of construction ("CIAC") and applied to reduce rate base in the Company's next base rate case proceeding. Under the Company's proposal, this revenue would flow to the Company's bottom line as increased earnings. If the IES is required in order to make capital expansion possible, then these revenues should be used to offset the plant investment that is required to expand service.

DES – DPA recommends that the PSC reject the Company's proposed DES for several reasons. First, the purpose of the DES is unclear. While the Company indicated that the purpose of the DES was "...to support the administration and implementation of the proposed service offerings along with the enhanced customer growth anticipated as a result of the proposed natural gas expansion service offerings" (*id.* at 16), it appears that the real purpose of the DES is to compensate the Company for declining per customer usage. (Response to PSC-10). If declining consumption is causing the Company financial distress, then it should file a base rate case where all revenues and costs can be properly evaluated. Second, if the purpose of the DES is to support expansion activities in Sussex County, then it should be rejected because it will result in an undue and unjust subsidy by existing customers to customers in the expansion area. Third, if the DES is intended to compensate the Company for the proposed CFS and CMS, then this charge is unnecessary, given that the DPA recommends that these services be provided on an unregulated basis, as discussed below.

CFS and CMS – DPA is not opposed to Chesapeake offering these programs *if* they are offered on an unregulated basis. Ratepayers should not pay for these programs nor should they be at risk for any uncollectibles that may result from these programs. If the Company does offer these programs on an unregulated basis, then it should be required to use dedicated personnel and other resources that are not involved in providing regulated service to avoid issues of cost allocation and possible subsidization of unregulated activities by regulated activities.

Tariff Revisions – DPA does not oppose the Company's proposed tariff amendment to change the measure of service installations from the current method of six (6) times net-revenue test to an Internal Rate of Return-based model. In addition, DPA does not oppose the Company's proposal to eliminate tariff provisions that prohibit charging for service installations within (75) feet of an existing distribution main, or for extension charges of less than (100) feet.

DPA looks forward to discussing its recommendations with the other parties at the upcoming workshop on December 10, 2012.

/s/ Michael Damian Sheehy
Michael Damian Sheehy
Public Advocate

Dated: November 30, 2012